IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 29 of 1984

For Approval and Signature:

Hon'ble MR.JUSTICE R.K.ABICHANDANI and
MR.JUSTICE R.BALIA.

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1. Whether Reporters of Local Papers may be allowed to see the judgements?

2. To be referred to the Reporter or not?

3. Whether Their Lordships wish to see the fair copy of the judgement?

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder?

5. Whether it is to be circulated to the Civil Judge?

COMMISSIONER OF INCOME TAX

Versus

JAYKRISHNA HARIVALLABHDAS

Appearance:
MR MJ THAKORE FOR MR MANISH R BHATT for Petitioner
MR SN SOPARKAR AND DA MEHTA appear as Amicus Curie

CORAM : MR.JUSTICE R.K.ABICHANDANI and
MR.JUSTICE R.BALIA.
Date of decision: 14/02/97

ORAL JUDGEMENT
(Per Rajesh Balia, J)

1. At the instance of Commissioner of Income Tax, the Income Tax Appellate Tribunal, Ahmedabad Bench A has submitted the statement of case and referred the

following questions of law arising out of its order in ITA No. 1951/Ahd/81 for the assessment year 1977-78:

"Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in coming to the conclusion that the assessee was entitled to claim capital loss of Rs.27,154/- under the provisions of Section 46(2) of the Income-tax Act, 1961"

2. The assessee had claimed before the Income Tax Officer a loss of Rs.27,154/- being loss on shares of M/s. Indian Bearings Limited and H.K. Sons Private Limited under the head `Capital Gains'. The assessee's case was that the company with respect to whose shares the loss had been claimed had gone into voluntary liquidation and nothing was distributed by those companies to its members, therefore, the assessee received nil consideration for his holdings in the companies. He claims that capital loss should have been computed under Section 46(2) read with Section 48 and dealt with under the provisions of Income Tax Act as such. The Income Tax Officer as well as the C.I.T.(Appeals) held that on liquidation of the company, no event of transfer of asset either by liquidator or by the shareholder takes place so as to give rise to the question of computation of capital loss chargeable under the head, capital gains. Reliance was placed on a decision of the Supreme Court in the case of C.I.T. Gujarat vs. R.M.Amin reported in 106 ITR 306. The Tribunal found that provisions of Section 46(2) apply in the event of liquidation of Indian Companies and the decision in R.M. Amin's case, which was rendered in the case of foreign company, which was not governed by the provision of Section 46(2) of the Income Tax Act, was not applicable to the present case. In view thereof it allowed the appeal of the assessee and held the capital loss to be considered for the purposes of computing the income taxable for the assessment year in question.

3. It will be appropriate to produce Section 46 which has remained unchanged as originally enacted.

"Capital gains on distribution of assets by companies in liquidation

46.(1) Notwithstanding anything contained in Section 45, where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall not be regarded as a transfer by the company for the purposes of Section 45.

(2) Where a shareholder on the liquidation of a company receives any money or other assets from the company, he shall be chargeable to income-tax under the head "Capital gains", in respect of the money so received or the market value of the other assets on the date of distribution, as reduced by the amount assessed as dividend within the meaning of Sub-clause (c) of clause (22) of Section 2 and the sum so arrived at shall be deemed to be the full value of the consideration for the purposes of Section 48."

There was no corresponding provision like the one referred to above in the Indian Income Tax Act, 1922 which was replaced by Income Tax Act, 1961.

4. A brief preview of law relating to Capital Gains under 1922 Act, in the context of controversy will not be out of place. By Finance (Amendment) Act 1947 Section 12B was inserted in the 1922 Act with effect from 1.4.1946, and Capital Gains arising after 31.3.1946 were subjected to Income Tax. Prior to that capital gains were not chargeable to tax In its first insertion third proviso to Section 12B provided that in distribution of capital asset on the dissolution of a firm or other association of persons or on the liquidation of a company shall not for the purpose of Section 12B be treated as sale, exchange or transfer of capital assets. Section 12B became inoperative with the commencement of Indian Finance Act, 1949 but was revived by the Finance Act, 1956 and the proviso to Section 12B as inserted in the Act, in 1956 omitted reference to distribution of capital assets on liquidation of a company. The controversy arose under 1922 Act as to whether on distribution of assets or disbursement of cash on liquidation of a company amounts to a transfer or not, for the purposes of invoking the provisions of capital gains. The revenue had been contending that it does amount to a transfer and, drew support from change in terminology of the proviso as was inserted in 1946 and as was made applicable in 1956. While third proviso to Section 12B, in 1946 stated that such distribution shall not be treated as a transfer of capital asset and subsequently in 1956 version of the provision reference to distribution of asset or cash on liquidation of company was omitted. This omission as per revenue indicated that legislation wanted to treat the distribution of capital assets on dissolution of a company in liquidation, as a case of transfer of Capital Asset, viz., shares. It

appears that in the wake of this controversy specific provision came to be enacted in Act of 1961 for the purpose of dealing with the case of distributions on liquidation of a company. While Section 46(1) declared that so far as the company is concerned, notwithstanding anything contained in Section 45 such distribution is not to be regarded as a transfer by the company for the purpose of Section 45, and subsection (2) was enacted to subject the shareholders to the charge of capital gains on liquidation on distribution of assets on the liquidation of a company. While subsection (1) stated in no uncertain terms that such distribution shall not be regarded as transfer by the company for the purpose of Section 45 notwithstanding anything contained in Section 45. Subsection (2) stated that it shall be chargeable to income tax under the head capital gains in respect of the money so received or other asset received from the company and also provided as to what shall be the value of full consideration for the purpose of computing capital gains under Section 48.

5. The controversy raised under the 1922 Act came to be decided by the Supreme Court in C.I.T., Madras v. Madurai Mills Co. Ltd. reported in 89 ITR 45. The Court declared,

> "When a shareholder receives money representing his share on distribution of the net assets of the company in liquidation, he receives that money in satisfaction of the right which belonged to him by virtue of his holding the shares and not by operation of any transaction which amounts to sale, exchange, relinquishment or transfer."

6. With reference to revenue's contention about provisions made in the third proviso to Section 12B in the Act of 1946 and subsequent omission of the reference to distribution of assets on liquidation in proviso to Section 12B as amended by Finance (No.3) Act, 1956, the Court held it to be clarificatory in character and not by way of creating any legal fiction.

7. That being the determining factor of the law independent of Section 46 it must be held that while subsection (1) of Section 46 is clarificatory in nature, subsection (2) creates a legal fiction for the purposes of charging the transaction to tax under head capital gains which is otherwise not so. The fact that without invoking Section 46, the position as prevailed under 1922 Act continued is clear from the decision of Supreme Court in C.I.T., Gujarat v. R.M.Amin reported in 106 ITR 368.

It was a case where on liquidation of a foreign company through voluntary liquidation a share holder received a sum in excess of face value of shares held by him, was sought to be taxed with reference to Section 46(2) the 1961 Act. The Court held that company has been defined under Section 2(17) of the Income-tax Act, 1961 and a foreign company does not fall within the definition of company defined under the Income Tax Act, would not be governed by the provisions of section 46(2). The provisions of Section 46 applies to companies in liquidation as are covered by definition under section 2(17) of the Act. Definition of Company under Section 2(17) for the purposes of Income Tax Act does not include a foreign company, therefore, the levy of tax on capital gains on distribution of assets by a foreign company in liquidation was not valid.

The court further went on to hold :

"The aforesaid section in our view was enacted both with a view to make shareholders liable for payment of tax on capital gains as well as to prescribe the mode of calculating the capital gains to the shareholders on the distribution of assets by a company in liquidation. But for that subsection, as already mentioned, it would have been difficult to levy tax on capital gains to the shareholders on distribution of assets by a company in liquidation."

8. Therefore reading of Section 46 in the aforesaid light makes it clear that legal fiction has been created. According to this legal fiction firstly a shareholder of the company on liquidation that company is chargeable to income tax under the head capital gains, and secondly, in respect of money received or the market value of other assets received on the date of distribution as reduced by the amount assessed as dividend within the meaning of Section 22(2)(c) is to be deemed to be full value of consideration for the purpose of Section 48. These two legal fictions inhere the import the necessary ingredient of calculations of capital gains under Section 48, the relevant part of which reads as under:

"48. The income chargeable under the head "Capital gains" shall be computed, by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset the following amounts, namely:-

(i) xxxxxxxxxxxxxxxx

(ii) the cost of acquisition of the asset and
the cost of any improvement thereto:
(iii) xxxxxxxxxxxx"

That is to say for the purpose of computing capital gains there has to be existence of a capital asset. A transaction has to be treated as its transfer resulting in sale or extinguishment of any right therein and full value of consideration has to be adjusted against cost of acquisition of the assets so transferred and the balance is to be treated in accordance with the provisions of the Act. For giving effect to fictions enacted under Section 46(2) all the necessary requirement too has to be assumed to be existing, if the fiction is to be carried to its logical end.

Full effect must be given to statutory fiction and it should be carried to its logical conclusion said Mahajan, J. in State of Bombay v. Pandurang Vinayak reported in AIR 1953 SC 244:

"If you are bidden to treat an imaginary state of affairs a real, you must surely, unless prohibited from doing so, also imagine as real the consequence and incidents which if the putative state of affairs had in fact existed, must inevitably have flowed from or accompanied it"

Said Lord Asquith in East End Dwelling Co. Ltd. vs. Finsbury Borough Council (1951) 2 All E.R. 587 (HL) and quoted with approval in C.T.I. Delhi vs. Teja Singh reported in AIR 1959 SC 352 when it opined:

"To that effect it would be proper and even necessary to assume all those facts on which alone the fiction can operate"

Thus assuming extinguishment of shareholders interest on liquidation in shares held by him as transfer is a necessary assumption accompanying liquidation of company and computation of `capital gain' as a result thereof, whether income or loss, a logical conclusion of operation of Section 48 in such state of affairs.

9. Ordinarily operating Section 45 to consider any transaction to be a transfer of capital asset by any of the modes referred in Section 2(47) of the Act, apart from the legal fictions created therein, envisage passing of consideration from one hand to another and passing of rights, notwithstanding extinguishment in the hands of

transferer to the transferee whether in the form of tangible gain or augmentation of the existing rights of others. It was because of this on liquidation return of corpus to the shareholders who were otherwise entitled to the same as a matter of right was not be held to be transfer within the meaning of Section 2(47), because on extinguishment of their rights in shares and their having received cash or assets in place of rights which he held in shares no corresponding rights accrue in any one for that consideration. However, once a legal fiction is created to treat the receipt or assets on distribution of liquidation in the hands of a shareholder it inhers transfer of assets by extinguishment of rights, by the recipient of consideration and once that fiction comes into existence it must lead to its logical conclusion in computation of capital gains in accordance with the provisions of the Act, whether ultimate result is found to be in gain or loss.

10. The contention of the learned counsel for the revenue that there is no deeming provision to treat the transaction as transfer and the provision is only charging section to tax receipt of cash or asset by the shareholder on liquidation as capital gain on a closure scrutiny cannot be accepted. The provision is not enacted simpliciter to charge the receipt of cash or value of asset to tax, which is otherwise capital receipt, but provides to tax income imbedded in such receipt or asset chargeable to tax under head capital gains. It is inherent in the concept of consideration that it is in lieu of something. Section 46(2) states that the sum arrived at after adjusting deemed dividends under Section 2(22)(c), if any, is to be treated as full value of consideration for the purpose of Section 48, that is to say, the provisions of Section 48 has to be read along with Section 46 to make it a complete reading. As noticed above, section 48 speaks in no uncertain terms about consideration received as a result of the transfer of the capital asset. In other words on liquidation of a company, which is a company within the meaning of Section 2(17) of the Act, the existence of shareholders' right to receive surplus, if any, is to be treated as capital asset and its extinguishment as transfer of such capital asset. Then only the deeming provision for computing capital gains can operate. Computation of Capital Gains has to be made accordingly by adjusting cost of acquisition of shares against consideration that reaches the shareholder on extinguishment. The contention that Section 46 only creates a fiction for taxing the receipts or value of the assets in case it exceeds cost of acquisition but if the net amount turns out to be

negative in value cannot be treated as a loss under the head capital gains simply cannot be accepted on the plain reading of Section itself. Section 46(2) does not provide that result of computation under Section 48 has to be treated differently under other provisions of Income Tax Act than other result of computation under Section 48.

11. The section creates not merely the charge but directs the taxable income to be computed under the head `capital gains'. The phraseology used by the legislation is not that cash or value of the assets received by a shareholder on liquidation is to be charged to tax as a capital gains but makes it chargeable under the head capital gains by further providing computation under Section 48 in respect of what is considered as consideration. Along with the charge entire computation provisions for charging the capital gains is made applicable to such computation. Therefore, extinguishment, partly or fully of right of shareholder to surplus (Capital Asset for the purpose of Section 46(2)) to be treated as transfer and as and when such extinguishment takes place, treating such extinguishment as transfer, the net result of such transfer has to be worked out or computed as per Section 48 of the Act. If result of such computation under the head `capital gains' is a positive balance it is to be added in total income chargeable to tax augmenting the same. If the balance is negative it has to treated under the chapter titled, `set off and carry forward losses' in accordance with the provisions to the extent the same are permissible.

12. The contention submitted by Mr. Soparkar one of the counsel, who intervened for assisting the court that the computation is to be made in a manner so as to reduce the cost of acquisition to nil and if there is not sufficient consideration thereafter which could be adjusted against cost of acquisition, computation should not be carried out so as to result in a capital loss, also cannot be accepted.

13. It was suggested in this connection that as and when the return of capital gains comes in the hands of shareholder in piece meal as per the accounting practice it should be adjusted against cost of acquisition of shares. However, until such receipt or value of asset exhausts, the cost of acquisition, it may not be treated as either capital gain or capital loss and if there is no receipt, there is no adjustment of cost of acquisition and consequently process does not go further. In effect plea is that in no case, whether any sum is received or

nothing is received, there can be any computation of `capital gain' which results in Capital loss to be treated as such. Having carefully considered the plea we are unable to sustain the plea that purpose of enacting Section 46(2) was only to tax surplus embedded in the receipts.

This plea negates the expression used by the legislation that the sum so arrived at be deemed to be `full value of consideration' for the purpose of Section 48'.

Section 48 provides for mode of computing income under head `capital gain'. The mode of computation shorn of all technicalities and other complexities is to deduct from full value of consideration received or accruing as a result of transfer of the capital asset, the cost of acquisition of asset. It does not envisage that in all cases such computation must result in surplus or gains. Section 4 of the Act makes the income computed in accordance with the provisions of the act subject to tax. Section 46(2) which has also been held to be charging section for bringing the result of receipts by member of a company on its liquidation too provides for computation of capital gains in accordance with Section 48, for which receipt or value of asset after deducting sum assessed as divided under Section 2(22)(c), if any, is to be deemed to be full value of consideration. Entire receipt or value of asset has not been subjected to charge, but what has been subjected to tax is event of receipt on liquidation of a company giving rise to capital gain, by treating it to be consideration. Consideration in ordinary sense means something in lieu of or exchange of. It does not provide, that on computation of Capital gain as per Section 48, surplus if any only is to be charged to tax as capital gains. This is how it was suggested to us to read the provision. On the contrary, the provision in question Section 46(2) does not provide any such further inhibition against treatment of balance. Such balance resulting as per computation made in accordance with Section 48 has to be subjected to charge of tax as per the provisions of the Act. Section 71 of the Act envisages where computation under any head of income is a loss, the assessee is entitled to set off such loss against computation of income assessable under other head for that year. Section 74 specifically provides where in respect of any assessment year the net result of computation under head Capital Gains is a loss to the assessee, the same may be carried forward, if cannot be set off against income of that year. Thus the computation of income under any head, including under

head capital gain envisages a situation where such computation may result in negative balance or loss. In other words, computation of income chargeable to tax includes computation of loss as well for the purpose of levy of tax in accordance with the provisions of the Act and to be treated accordingly. There is nothing in the provision of Section 46(2) which excludes the applicability of other provisions of the Act dealing with set off and carry forward of loss under any head of income to the computation of income chargeable to tax under head capital gains under it.

14. We are also not impressed with the contention that there has to be several computations in piece meal whenever there is a cash exchange or receipt of asset on distribution of the asset on liquidation of a company.

15. Section 511 of the Companies Act provides that subject to the provisions of the Act as to preferential payments, the assets of a company shall, on its winding up, be applied in satisfaction of its liabilities pari pasu and, subject to such application, shall, unless the articles otherwise provide, be distributed among the members according to their rights and interests in the company. Section 529 of the Companies Act under Chapter V, which is applicable to every mode of winding up makes the law of insolvency with respect to estates of persons as an insolvent in the matter of distribution of the assets of the company amongst creditors. Section 67 of the Provincial Insolvency act which is applicable in the State of Gujarat, provides that the insolvent is entitled to any surplus of the proceedings taken thereunder. These provisions read together leave no room of doubt that the question of payment to the contributories of liquidation of a company would arise only in case a surplus is left after discharge of all its liabilities towards creditors or to the expenses of proceedings, that is to say the return of capital to shareholders whether under voluntary liquidation or compulsory liquidation is a final act of such winding proceedings. It is in that context, the expression `on liquidation' has to be read when provisions of Section 46(2) are to be made applicable for the purpose of computing capital gains or as the case may be. There is a vital distinction in the expression `a company in liquidation' and `a company on liquidation'. The word `on' have many shades of meaning in different contexts. In Strouds's Judicial Dictionary about the word `on', it has been stated,

"Though "on," or "upon" a date or event may, prima facie, have an inclusive meaning, yet

either word will mean "before," "simultaneously with," or "after," according to the context and subject-matter.

In the present case, we are concerned with return of capital of shareholder, which is a final act in the process of winding up. The conclusion to which we have reached is that even extinguishment of right of shareholder amounts to transfer for the purposes of Section 48. In this context, the word, `on liquidation' must necessarily refer to the date on which the company was wound up or the winding up process is complete. Liquidation simpliciter in the context of winding up of company may mean winding up of corporation where that assets are distributed to those entitled to receive them, process of reducing assets to cash discharging liabilities and dividing surplus or loss amongst contributions or members. As we have noticed the stage of distribution of surplus amongst contribution or members so called owners of the company is the final stage of liquidation as until discharge of liabilities and cost of liquidation the members are not entitled to any return of their contribution. Until the company is finally wound up the right of shareholders or members to receive the surplus, if any, remain in tact, which is the only right that survives in a shareholder of a company in liquidation. It comes to an end or extinguishes only on completion of winding up. Section 509 in the case of voluntary winding up of the Companies Act read with Rule 283 of the Company Court Rules, when the court makes an order dissolving the company either on report of the Official Liquidator that affairs of the company has been completely would up or it is of the opinion that liquidator cannot proceed further with winding up of company. The winding up concludes as per Rule 285 of the Company Court Rules on the date the order of the court dissolving the company has been reported by the Liquidator to the Registrar.

Under Rule 283, on making of the order by the Court of the dissolution of company any balance in the hands of Official Liquidator whether any unclaimed dividends payable to creditors or undistributed assets refundable to contributions, or otherwise is to be deposited in Companies Liquidation Account in the Reserve Bank of India, drawing final curtain on the entitlement of any claims outstanding the company on its dissolution, though return of capital to contributions takes place while company is in liquidation or is being would up, before dissolution takes place so long as their own funds with Official Liquidator, the entitlement to

contributions to return of capital remain alive while company is in Liquidator, but comes to an end on its dissolution when winding up is complete.

16. In this connection reference may be made to Section 547 of the Companies Act which deals with notification that a company is in liquidation, which refers to such a company being wound up and also to Section 551 of the Companies Act which refer to a stage when liquidation is not concluded. In contrast to this Section 497 and Section 509 and Section 481 refers to stage where order of dissolution of company can be made where the affairs of the company have been completely wound up. These provisions suggest that such a complete winding up of the affairs of the company is reached before actual order of dissolution is made. These provisions referred to above also makes us think that statutorily it is not possible to read company in liquidation for `company on liquidation', to make the provisions of Section 46 applicable, on the date of commencement of liquidation proceedings when the order for winding up is made or resolution for voluntary winding up is made and the winding proceedings commences as the company on such commencement of winding up becomes a company in liquidation and at least until stage is reached to distribute surplus.

17. In case of piece meal distribution of cash or assets which has been left surplus after discharge of liability, it cannot be said that the rights of shareholders are extinguished before the affairs of the company are wound up so as to give effect to the expression `full value of consideration' for the purpose of Section 48. `Full value of consideration' and its adjustment against cost of acquisition of asset deemed to have been transferred (in the present case by extinguishment of rights to receive surplus, if any,) are two essential ingredients for computation of capital gains under Section 48. In that situation the only reasonable inference to be drawn is that expression `on liquidation' under section 46(2) refers to date when the affairs of the company are completely wound and right of shareholder to return of capital after discharge of liability of company and preferential payments comes to an end. It may further be noticed that the entire receipts, whether in cash or in the form of assets are not be taxed only as capital gains under the head capital gains but part of it is referable to the distribution of accumulated profits, which are liable to be taxed as dividends in accordance with the provisions of Section 2(22)(c) and the same has to be deducted from the cash or

market value of assets received and only the balance is to be treated as `full value of consideration' for extinguishment of rights of shareholder as on that date to be fixed under the head capital gains.

18. Viewed from the aforesaid angle, one must reach the conclusion that as on the date affairs of the company are fully wound up and entitlement of shareholder to any return of its capital comes to an end any disbursement made to shareholder either by way of cash or asset has to be treated in the hands of recipient shareholder full value of consideration on deemed transfer of his capital asset as a result of extinguishment of all rights has to be deemed to be resulting in capital gain or loss as the case may be as per result of computation made under Section 48 of the Act. Though the value of asset have to be taken at its market value as on the date of actual receipt as a result of joint reading of Section 46(2) and Section 55(2)(b)(iii) of the Act which provides for determination of cost of acquisition in the hands of recipient for determination of capital gains in his hands whenever he transfers such asset after its receipt by him.

19. The contention that this provision should apply on actual receipts only also cannot be accepted for yet another reason because acceptance of that would lead to incongruous and anomalous result as will be seen presently. The acceptance of this view would mean whereas even in a case where a sum is received howsoever negligible, or insignificant it may be would result in computation of capital gains or loss, as the case may be, but in a case where nothing is disbursed on liquidation of a company the extinction of rights, would result in total loss with no consequence. That is to say on receipt of some cost however insignificant it may be, the entire gamut of computing capital gains for the purpose of computing under the head `capital gains' is to be gone into computing income under the head capital gains, and loss will be treated under the provisions of Act, but where there is nil receipt of the capital the entire extinguishment of rights has to be written off without treating under the Act as a loss resulting from computation of capital gains. The suggested interpretation leads to such incongruous result and ought to be avoided if it does not militate in any manner against object of the provision and unless it is not reasonably possible to reach that conclusion. As discussed above, once a conclusion is reached that extinguishment of rights in shares on liquidation of a company is deemed to be transfer for operation of Section

46(2) read with Section 48, it is reasonable to carry that legal fiction to its logical conclusion to make it applicable in all cases of extinguishment of such rights, whether as a result of some receipt or nil receipt, so as to treat the subjects without discrimination, where there does not appear to be ground for such different treatment Legislature cannot be presumed to have made deeming provision to bring such anomalous result.

20. For the reasons stated above, we answer the Question referred to us in affirmative, that is to say, in favour of the assessee and against the revenue. No costs.

(Per R.K. Abichandani, J)

1. I find myself in agreement with the conclusions of my esteemed brother in his erudite judgement just delivered.

2. The short question that arises in the matter is as to whether a shareholder who on distribution of money or other assets on the company being wound up gets nothing and suffers a loss can treat it as a capital loss by virtue of Section 46(2) of the Act.

3. The provision of Section 46 deal with capital gains on distribution of assets by companies in liquidation. Sub section (1) of Section 46 lays down that notwithstanding anything contained in section 45, where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall not be regarded as a transfer by the company for the purposes of Section 45. This means that there is no question of computing any profits or gains of the company arising from such distribution of assets in favour of the shareholders. When a shareholder on the liquidation of a company receives money or other assets according to his holding in satisfaction of his rights and interests in the company which is wound up, that is not as a result of any transaction in respect of such rights and but for section 46(2) it would not have been possible to charge tax in respect thereof under the head `capital gains'. Section 46(2) was enacted with a view to making shareholders liable for payment of tax on capital gains as well as to prescribing the mode of calculating the capital gains to the shareholders on distribution of assets of a company on its liquidation. Though the

distribution of such assets of the company on its liquidation is not a transfer, a provision is made under subsection (2) of Section 46 which will have the effect of treating such distribution in the hands of the shareholder in satisfaction of his rights and interests in his holdings, as chargeable to income tax under the head capital gains as provided therein. Since there is no transfer involved and therefore there could not be consideration fixed for transfer, a fiction is created to work out full value of consideration for the purpose of the mode of computation and deductions in respect of the income chargeable under the head `capital gains'. Where the net result of the computation under the head `capital gains' is a loss to the assessee, the loss can be set off or carried forward in light of the provisions of Section 71 and 74 as may be applicable. Therefore, even if the sum received on such distribution of the assets of the company to the shareholders is negligible, say one rupee and loss is worked out as a result of the computation under the head capital gains, such shareholder-assessee will get the benefit of set off against income or carry forward as the case may be. The thrust of the provisions of Section 46(2) is that though there is no transfer of the asset on its distribution by the company on its liquidation and such distribution cannot be computed under the head `capital gains', the same even has to be computed under that head when it comes to assessing the shareholder. A shareholder who has incurred total loss in a transaction of sale of shares would be entitled to claim set off or carry forward, as may be, in respect of capital loss suffered, by virtue of Section 45 read with Section 48, 71 and 74. There is therefore no reason why a shareholder who in distribution of assets has not received any deemed consideration in satisfaction of his rights and interests in the holding and has thereby suffered a total loss, cannot claim the benefit of set off or carry forward of the loss suffered by him. Otherwise, a startling and unjust situation may arise where the receipt of even one paise would enable him to claim set off or carry forward of capital loss as worked out under Section 48, while, a shareholder who is a shade worse off and gets nothing in even of such total loss should be denied the effect of Section 46(2) read with 71 and 74 of the Act and be put to a perpetual loss. Therefore, even where the receipt is nil on the date of distribution on the liquidation of the company, the case of such shareholder will fall under Section 46(2) and the deemed full value of the consideration for the purpose of Section 48 will be regarded as `nil' and on that basis the income chargeable under the head `capital gains' has to be computed under Section 48.

4. The question referred to us is, for the reasons stated in the judgement of my esteemed brother and for the reasons given above, answered in the affirmative in favour of the assessee and against the revenue. The reference stands disposed of accordingly with no order as to costs.

We record our appreciation for the assistance rendered by the learned counsel for the revenue as well as by Mr.S.N.Soparkar and Mr. D.A. Mehta as intervenors.